

**Auto Dealers § 263A Audit Plan**  
**UIL No.: 263A.01-01, 263A.01-02, 263A.02-11,**  
**263A.02-12, 263A.04-00, 263A.04-04, 263A.04-05, 263A.04-06**  
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**Step 1: Determine off-site storage portion of dual-function storage facility<sup>1</sup>:**

- (1) *Identify Total Sales*<sup>2</sup>
- (2) *Identify On-site sales*<sup>3</sup>
- (3) *Identify Off-site sales*<sup>4</sup>:
  - a. Vehicles taken in trade or purchased at auction and subsequently resold at wholesale:<sup>5</sup>
    - (i) New Vehicles
    - (ii) Used Vehicles
  - b. Vehicles sold to another dealership at cost<sup>6</sup>
  - c. Vehicles leased<sup>7</sup>
  - d. Vehicles sold as part of a fleet sale<sup>8</sup>
  - e. Wholesale Parts<sup>9</sup>
  - f. Parts sold to non-end users<sup>10</sup>
  - g. Internet sales of vehicles and parts
  - h. Catalog sales of parts<sup>11</sup>
  - i. Phone sales of parts
- (4) *Determine Dual-function: Calculate Off-site storage percentage*<sup>12</sup>:
$$\frac{\text{Non-Retail Sales}}{\text{Total Sales}} = \text{Off-site Storage Percentage}^{13}$$

<sup>1</sup> TAM 200736026: Issue #7: Do the following sales constitute on-site sales to retail customers? §§§ 1.263A-3(c)(5)(ii)(D), 1.263A-3(c)(5)(ii)(E), 1.263A-3(c)(5)(ii)(F)

<sup>2</sup> §§§ 1.263A-3(c)(5)(iii)(A), 1.263A-3(c)(5)(iii)(B)(1)(i), and 1.263A-3(c)(5)(iii)(B)(1)(ii).

<sup>3</sup> See Audit Plan Step 1: Definitions and Key Terms: § 1.263A-3(c)(5)(ii)(D) §§ 1.263A-3(c)(5)(ii)(E)(1), 1.263A-3(c)(5)(ii)(E)(2)

<sup>4</sup> See Audit Plan Step 1: Definitions and Key Terms: § 1.263A-3(c)(5)(ii)(F),

<sup>5</sup> TAM 200736026: Issue #7.a.

<sup>6</sup> TAM 200736026: Issue #7.b.

<sup>7</sup> TAM 200736026: Issue #7.c.

<sup>8</sup> TAM 200736026: Issue #7.d.

<sup>9</sup> TAM 200736026: Issue #7.e.

<sup>10</sup> § 1.263A-3(c)(5)(ii)(E)(1)

<sup>11</sup> § 1.263A-3(c)(5)(ii)(D)

<sup>12</sup> TAM 200736026: TAM Issue #8: Is Taxpayer's storage facility at Location 1: an on-site, off-site or dual-function storage facility? §§§ 1.263A-3(c)(5)(ii)(G), 1.263A-3(c)(5)(iii)(A), 1.263A-3(c)(5)(iii)(B),

<sup>13</sup> See Audit Plan Step 1: Definitions and Key Terms: §§ 1.263A-3(c)(5)(iii)(B)(1), 1.263A-3(c)(5)(iii)(B)(2), : The total of off-site sales divided by Total Sales = Dual storage off-site storage %. If this % is 10% or less, of the costs of a storage facility, no dual-function storage and handling costs are required to be capitalized. If this % is 90% or more, all of the dual-function storage and handling costs are required to be capitalized. If this % is greater than 10% the calculated % represents the % of off-site storage required to be capitalized. In other words, if the percentage is 40%, then 40% of the dual storage costs are required to be capitalized and included in the numerator of the storage and handling absorption ratio. §1.263A-3(d)(3)(i)(D)(1).

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**Step 2: Determine off-site portion of dual-function storage facility costs:**

*(1) Identify and calculate dual-function storage facility lots/locations<sup>14</sup>:*

- a. Lots in front of show rooms
- b. Lots behind the show rooms
- c. Any other lots adjacent or contiguous to the show rooms or car displays

*(2) Identify total costs of dual-function storage facility/location<sup>15</sup>*

The costs attributable to storage facilities generally consist of:

- Direct and indirect labor costs, pension plans and other fringe benefits
- Occupancy expenses
  - Rent
  - Depreciation
  - Insurance
  - Security
  - Taxes
  - Utilities
  - Maintenance
- Materials (direct & indirect) and supplies
- Vehicles & Equipment
  - Rent
  - Maintenance
  - Depreciation
  - Insurance
  - Tools
- Telephone
- Travel
- General and administrative costs that directly benefit or are incurred by reason of the taxpayer's resale or production activities<sup>16</sup>
- Any other cost incurred for the benefit of or in the performance of the taxpayer's resale or production activities<sup>17</sup>

**=TOTAL DUAL-FUNCTION STORAGE FACILITY COSTS**

<sup>14</sup>See TAM 200736026: Issue#8: Taxpayer's storage facility at Location 1 is a dual-function storage facility.

<sup>15</sup> §§ 1.263A-1(e)(3), 1.263A-3(c)(2), 1.263A-3(c)(5) and Step 1-Key definitions.

<sup>16</sup> This amount is most like mixed service costs.

<sup>17</sup> §§ 1.263A-1(e)(3)(i) and 1.263A-1(e)(3)(ii)

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*(3) Determine capitalizable portion of dual-function storage facility costs:*

- a. Calculate capitalizable off-site portion of dual-function storage facility cost<sup>18</sup>:

$$\begin{array}{l} \text{Total dual-function storage facility storage costs}^{19} \\ \times \text{Off-site storage dual-function storage allocation ratio}^{20} \\ \hline \text{Capitalizable Portion of dual-function storage facility: Off-Site Storage} \end{array}$$

**Step 3: Determine off-site storage facilities<sup>21</sup>:**

- (1) Identify off-site storage facility locations<sup>22</sup>*  
*(2) Identify costs of off-site storage facility/location<sup>23</sup>*

**Step 4: Identify Production costs<sup>24</sup>:**

- (1) Service Department – Production Costs<sup>25</sup>*
- a. Identify installation costs to dealer-owned new and used cars  
b. Identify installation costs to dealer-owned new and used trucks
- (2) Body Shop – Production Costs<sup>26</sup>*
- a. Identify installation costs to dealer-owned new and used cars  
b. Identify installation costs to dealer-owned new and used trucks
- (3) Other Departments – Production Costs<sup>27</sup>*
- a. Identify installation costs to dealer-owned new and used cars  
b. Identify installation costs to dealer-owned new and used trucks

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<sup>18</sup> See TAM 200736026, Issue 8; § 1.263A-3(c)(5)(iii)(A), § 1.263A-3(c)(5)(iii)(B).

<sup>19</sup> See Answer of Step 2(2)

<sup>20</sup> See Answer of Step 1(4), § 1.263A-3(c)(5)(iii)(B).

<sup>21</sup> TAM Issue #9: Is the Taxpayer's storage facility at Location 1 an on-site, off-site or dual-function storage facility?  
Conclusion: Taxpayer's storage facility at Location 2 is an off-storage facility.

<sup>22</sup> See Steps 1 & 2: Definitions and Key Terms

<sup>23</sup> §§ 1.263A-3(c)(2), 1.263A-3(c)(5)(ii)(F). Audit Step 2-2 & Steps 1 & 2: Definitions and Key Terms

<sup>24</sup> TAM 200736026, Issue 1: 1a(ii) & (iii) and 1(b)(ii) & (iii) When Taxpayer or a subcontractor installs parts to new and used vehicles owned by Taxpayer, the installation of parts may constitute production activities under sections 263A(g)(1) and 1.263A-2(a)(1)(i).

<sup>25</sup> See § §§ 1.263A-1(e)(2)(i); 1.263A-1(e)(3)(i); 1.263A-1(e)(3)(ii); 1.263A-1(e)(4)(ii)(C), 1(e)(3)(ii)(W);

<sup>26</sup> See Footnote #25

<sup>27</sup> See Footnote #25

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**Step 5: Identify Handling Costs<sup>28</sup>:**

*(1) Identify Handling Activities*

- a. Processing Costs – Service department and body shop installation of parts into customer owned vehicles<sup>29</sup>
- b. Assembling Costs – Service department and body shop installation of parts into customer owned vehicles<sup>30</sup>
- c. Transportation Costs<sup>31</sup>:
  - From the vendor to the taxpayer
  - From one taxpayer storage facility to another storage facility
  - From the taxpayer's storage facility to the taxpayer's retail facility
  - From the taxpayer retail facility to the taxpayer's storage facility
  - From one taxpayer retail facility to another taxpayer retail facility

*(2) Identify Handling Costs*

- a. Transportation<sup>32</sup>
- b. Service Department<sup>33</sup>
  - Processing Costs
  - Assembling Costs
- c. Body Shop<sup>34</sup>
  - Processing Costs
  - Assembling Costs

*(3) Other<sup>35</sup>*

- Cars as they come in
- Unloaded from trucks
- Cleaning of cars that come in
- How are returns of vehicles treated (not repos = purchasing costs)

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<sup>28</sup> TAM 200736026, Issue 5 Costs attributable to repair/installation activities with respect to customer-owned vehicles are handling costs under section 1.263A-3(c)(4). Costs attributable to certain minor repair/installation activities with respect to Taxpayer-owned vehicles are also handling costs.

<sup>29</sup> § 1.263A-3(c)(4)(ii)

<sup>30</sup> § 1.263A-3(c)(4)(iii)

<sup>31</sup> § 1.263A-3(c)(4)(v)

<sup>32</sup> § 1.263A-3(c)(2)

<sup>33</sup> § 1.263A-3(c)(2)

<sup>34</sup> § 1.263A-3(c)(2)

<sup>35</sup> § 1.263A-3(c)(2)

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**= TOTAL HANDLING COSTS**

(4) *Calculate capitalizable handling costs*<sup>36</sup>:

$$\frac{\text{Total Off-site dual-function storage facility handling costs}^{37} \times \text{Off-site storage dual-function facility allocation ratio}^{38}}{\text{Total Capitalizable Handling costs}}$$

**Step 6: Identify Purchasing Costs**<sup>39</sup>

(1) *Identify Purchasing Activities*<sup>40</sup>:

- a. The selection of merchandise<sup>41</sup>
  - (i) Determine how vehicles and parts are selected
  - (ii) Determine process for the purchasing of new car and trucks
    - Franchise agreements
    - Reconciliation of physical inventory and accounting records
  - (iii) Determine the purchasing process for used car and trucks
    - Valuation of trade-in
    - Service department's evaluation of vehicle
    - Title transfer
  - (iv) Determine process for parts department
- b. The maintenance of stock assortment and volume – Determine how inventory is tracked<sup>42</sup>
  - (i) Insurance on inventory: vehicles and parts
  - (ii) Determination who sets minimum inventory levels
  - (iii) How often is physical inventory count taken?
  - (iv) Who participates in the physical inventory count?

<sup>36</sup> TAM Issue # 5-Whether TP's repair/installation activities are handling costs. §§ 1.263A-3(c)(2), 1.263A-3(c)(4).

<sup>37</sup> §§ 1.263A-3(c)(2), 1.263A-3(c)(4).

<sup>38</sup> § 1.263A-3(c)(5)(iii)(B)(1) & (2) and Step 1(4)

<sup>39</sup> § 1.263A-3(c)(3): TAM 200736026: Issue #10 – Purchasing costs are not mixed service costs

<sup>40</sup> § 1.263A-3(c)(3)

<sup>41</sup> § 1.263A-1(c)(3)(i) (A)

<sup>42</sup> § 1.263A-1(c)(3)(i) (B)

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- c. The placement of purchase orders<sup>43</sup>
  - (i) Accounts Payable process
  - (ii) Reconciliation of the floor account
  - (iii) Perfection of title
    - Purchased vehicles
    - Trade-in(s)
    - Parts
- d. The establishment and maintenance of vendor contacts<sup>44</sup>
  - (i) Franchise Agreement
    - Possible franchise fee
- e. The comparison and testing of merchandise<sup>45</sup>.
  - (i) Service manager or other personnel consideration of trade-ins
  - (ii) Service Departments evaluation of trade-ins
  - (iii) Evaluation of auto auction purchases

(2) *Identify Purchasing Costs*

- a. See §§ 1.263A-3(c)(2) & 1.263A-1(e)(3)

**Step 7: Determine Total Mixed Service Costs<sup>46</sup>**

*(1) Identify mixed service costs departments/functions<sup>47</sup>*

- a. Personnel
- b. Accounting – Except purchasing costs according to § 1.263A-3(c)(3)
- c. Processing
- d. Security
- e. Legal
- f. Other similar departments

*(2) Identify total costs of mixed service departments/functions<sup>48</sup>*

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<sup>43</sup> § 1.263A-1(c)(3)(i) (C)

<sup>44</sup> § 1.263A-1(c)(3)(i)(D)

<sup>45</sup> § 1.263A-1(c)(3)(i)(E)

<sup>46</sup> TAM 200736026: Issue #11

<sup>47</sup> § 1.263A-1(e)(4)(i) & (ii)

<sup>48</sup> §§ 1.263A-1(h)(6), 1.263A-1(e)(i); 1.263A-1(e)(3)(ii)

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(3) *Calculate capitalizable portion of mixed service costs*

a. Identify & Calculate § 263A Labor<sup>49</sup>

Production Labor<sup>50</sup>

Purchasing Labor<sup>51</sup>

Capitalizable Dual-function Storage Labor<sup>52</sup>

+ Capitalizable Dual-function Handling Labor<sup>53</sup>

Total § 263A Labor<sup>54</sup>

b. Identify & Calculate Total Labor

Total Labor<sup>55</sup>

- Mixed Service Cost Labor<sup>56</sup>

Total Labor

c. Calculate simplified service cost ratio – labor based ratio<sup>57</sup>

$$\frac{\text{263A Labor}}{\text{Total Labor}} = \frac{\text{Simplified service cost ratio-}}{\text{Labor based allocation ratio}}$$

d. Calculate capitalizable portion of mixed service costs<sup>58</sup>

Total Mixed Service Costs<sup>59</sup>

x Simplified Service Cost Ratio<sup>60</sup>

Capitalization portion of mixed service costs

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<sup>49</sup> §§ 1.263A-1(h)(4), 1.263A-3(d)(3)(i)(F), 1.263A-1(e)(3)

<sup>50</sup> Step 4

<sup>51</sup> Step 6, § 1.263A-3(c)(3)

<sup>52</sup> Step 2, § 1.263A-3(c)(5)

<sup>53</sup> Step 5, § 1.263A-3(c)(4)

<sup>54</sup> § 1.263A-1(h)(4)(ii)

<sup>55</sup> § 1.263A-1(h)(4)(ii)

<sup>56</sup> § 1.263A-1(h)(4)(ii)

<sup>57</sup> §§ 1.263A-1(h)(4)(i)

<sup>58</sup> § 1.263A-1(h)(4)

<sup>59</sup> §§ 1.263A-1(h)(6); 1.263A-1(e)(3)(i); 1.263A-1(e)(3)(ii)

<sup>60</sup> § 1.263A-1(h)(3)

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**Step 8: Apportion Mixed Service Costs between Purchasing and Storage & Handling<sup>61</sup>:**

- (1) *Calculate amount of mixed service cost to be included in the numerator of the purchasing absorption ratio*

$$\frac{\text{Purchase Costs}}{\text{Purchasing Costs} + \text{Storage/Handling Costs}} \times \text{Capitalizable Mixed Service Cost}$$

- (2) *Calculate amount of mixed service cost to be included in the numerator of the storage/handling absorption ratio*

$$\frac{\text{Storage/handling Costs}}{\text{Purchasing Costs} + \text{Storage/Handling Costs}} \times \text{Capitalizable Mixed Service Cost}$$

**Step 9: Calculate Storage & Handling Ratio<sup>62</sup>:**

- (1) *Calculate Storage/handling Ratio<sup>63</sup>:*

- a. Calculate numerator of storage/handling ratio:

$$\begin{aligned} & \text{Capitalizable off-site storage costs}^{64} \\ & \text{Capitalizable portion of mixed service costs - Storage/handling}^{65} \\ & \text{Capitalizable Portion of dual-function facility: Off-site storage costs}^{66} \\ & + \text{Capitalizable Portion of dual-function facility: Handling costs}^{67} \\ & \underline{\text{Total Capitalizable storage/handling costs}} \end{aligned}$$

- b. Calculate storage/handling ratio<sup>68</sup>:

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<sup>61</sup> § 1.263A-3(d)(3)(i)(F)

<sup>62</sup> See TAM 200736026, Issue 4; § 1.263A-3(d)(3)(i)(D)

<sup>63</sup> § 1.263A-3(d)(3)(i)(D)

<sup>64</sup> Step 3

<sup>65</sup> Step 8

<sup>66</sup> Step 2(3)

<sup>67</sup> Step 5(3)

<sup>68</sup> § 1.263A-3(d)(3)(i)(D)



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$$\frac{\text{Total Capitalizable storage/handling costs}}{\text{Beg. Inventory} + \text{Purchases}} = \text{Storage/Handling Cost Ratio}$$

**Step 10: Calculate Purchasing Ratio<sup>69</sup>:**

*(1) Calculate numerator of purchasing ratio:*

$$\begin{aligned} & \text{Production Costs}^{70} \\ & \text{Purchasing Costs}^{71} \\ & + \frac{\text{Capitalizable portion of mixed service costs} - \text{Purchasing}^{72}}{\text{Total Capitalizable Purchasing Costs}} \end{aligned}$$

*(2) Calculate Purchasing Costs ratio<sup>73</sup>:*

$$\frac{\text{Total Capitalizable Purchasing Costs}^{74}}{\text{Purchases}^{75}} = \text{Purchasing Ratio}$$

**Step 11: Calculate Simplified Resale Combined Absorption Ratio<sup>76</sup>:**

*Calculate Combined Simplified Resale Absorption ratio:*

$$\begin{aligned} & \text{Purchasing ratio}^{77} \\ & + \frac{\text{Storage/handling ratio}^{78}}{\text{Combined resale absorption ratio}} \end{aligned}$$

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<sup>69</sup> § 1.263A-3(d)(3)(i)(E)

<sup>70</sup> Step 4

<sup>71</sup> Step 6

<sup>72</sup> Step 8(1)

<sup>73</sup> § 1.263A-3(d)(3)(i)(E)

<sup>74</sup> Steps 4,6,8

<sup>75</sup> 1120S-Schedule A

<sup>76</sup> § 1.263A-3(d)(3)(i)(C)(1)

<sup>77</sup> Step 10(2)

<sup>78</sup> Step 9(2)

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**Step 12: Calculate amount of additional 263A costs required to be capitalized<sup>79</sup>:**

*Apply combined ratio to current year § 471 costs:*

$$\begin{array}{rcl} & \text{Total Current Year § 471 Costs in Ending Inventory}^{80} & \\ \times & \text{Combined resale absorption ratio}^{81} & \\ & \text{Capitalizable additional § 263A costs} & \end{array}$$

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<sup>79</sup> § 1.263A-3(d)(3)(i)(A)

<sup>80</sup> § 1.263A-3(d)(3)(i)(C)(2) and § 1.263A-1(d)(2)

<sup>81</sup> § 1.263A-3(d)(3)(i)(C)(1)